

Internal Revenue Service
memorandum

CC:TL:Br2
MSRichmond

date: OCT 30 1987

to: District Counsel, San Diego CC:SD
Attn: Thomas Dombrowski

from: Acting Director, Tax Litigation Division CC:TL

subject: [REDACTED]

EIN [REDACTED]

This memorandum responds to your request of September 2, 1987, for technical advice. You asked whether the accumulated earnings tax applies to regulated financial institutions such as the [REDACTED] (hereafter referred to as the Bank).

You stated that the Bank has accumulated about \$ [REDACTED] in retained earnings, none of which constitutes reserves required by regulators of the banking industry. You further stated that the Bank maintains about \$ [REDACTED] for use in the event of (1) an earthquake (\$ [REDACTED]), (2) loss of a keyman (\$ [REDACTED]), (3) the acquisition of other banks (\$ [REDACTED]), and (4) an adverse resolution of a federal tax dispute involving a prohibited transaction in profit sharing (\$ [REDACTED]).

You indicated that the Bank is probably controlled by its founding family, though the family legally controls only about [REDACTED] percent of the stock in the Bank. The founding family has effective control of the Bank and serves as its president and chairman of the board. About [REDACTED] other shareholders also hold stock in the Bank.

Banks are generally taxed the same as other corporations. Treas. Reg. § 1.581-2. I.R.C. § 531 imposes on the accumulated taxable income of every corporation an accumulated earnings tax. Section 532(a) provides that the accumulated earnings tax shall apply to every corporation (other than those described in subsection (b)) formed or availed of for the purpose of avoiding the income tax with respect to its shareholders (or the shareholders of any other corporation) by permitting earnings and profits to accumulate instead of being divided or distributed.

Section 532(b) provides, in part, that the accumulated earnings tax shall not apply to (1) a personal holding company, (2) a foreign personal holding company, or (3) a corporation exempt from tax under subchapter F.

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The Bank does not purport to be either a domestic or foreign personal holding company, or a corporation exempt from tax under subchapter F. It is a publicly held corporation whose stock is traded over the counter.


The Second Circuit in Trico Products Corporation v. Commissioner, 46 B.T.A. 346 (1942), aff'd, 137 F.2d 424 (2d Cir. 1943), cert. denied, 320 U.S. 799 (1943), and Trico Products Corporation v. McGowan, 67 F.Supp. 311 (D.C. N.Y. 1946), aff'd, 169 F.2d 345 (2d Cir. 1948), cert. denied, 355 U.S. 899 (1948), held that the accumulated earnings tax applies to publicly held corporations. However, the Ninth Circuit in Golconda Mining Corporation v. Commissioner, 507 F.2d 594 (9th Cir. 1972), held that the accumulated earning tax does not apply to publicly held corporations, if no individual or limited group owns a majority stock interest.

In Rev. Rul. 75-305, 1975-2 C.B. 228, the Service concluded that it will not follow the Ninth Circuit decision in Golconda Mining Corporation. The Service further concluded that the accumulated earnings tax does apply, in appropriate cases, to publicly held corporations not only when legal control is vested in an individual or small group but also when merely effective control is present. See attached O.M. 70085, [REDACTED], A.O.D. (October 15, 1976).

While the above authorities do not involve the application of the accumulated earnings tax to commercial banks, these authorities show a policy decision that publicly held corporations are not exempt from the accumulated earnings tax. Aside from the exceptions identified in section 532(b), which are irrelevant here, neither section 532(a) nor section 532(b) contains any language suggesting the inapplicability of the provision to certain types or designations of corporations, per se. We see no reason why the accumulated earnings tax should not be applied in an appropriate case to a publicly held commercial bank that is availed of for the purpose of avoiding the income tax with respect to its shareholders by permitting earnings and profits to accumulate instead of being divided or distributed, as long as the control test set forth in O.M. 70085 is met.

PATRICK J. DOWLING

By:


ALFRED C. BISHOP, JR.
Chief, Branch No. 2
Tax Litigation Division

Attachment:
As stated